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Not-for-profit organizations industry developments - 1997; Audit risk alerts

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AUDIT RISK ALERTS

AICPA

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Not-for-Profit Organizations Industry Developments— 1997

Complement to AICPA Audit and Accounting Guide
Not-for-Profit Organizations

NOTICE TO READERS

This Audit Risk Alert is intended to provide auditors of financial statements of not-for-profit organizations with an overview of recent economic, industry, regulatory, and professional developments that may affect the audits they perform. This document has been prepared by the AICPA staff. It has not been approved, disapproved, or otherwise acted on by a senior technical committee of the AICPA.

Joel Tanenbaum
Technical Manager, Accounting Standards

The staff of the AICPA is grateful to the members of the AICPA Not-for-Profit Organizations Committee for their contribution to this document.

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Not-for-Profit Organizations Industry Developments—1997

Industry and Economic Developments

Overall, the effects of growth on the not-for-profit sector continue to lag behind those on the economy as a whole. Funding that not-for-profit organizations receive from private foundations has increased. Funding from the federal government has remained relatively steady. However, the use of block grants rather than specific program grants for government funding for social service programs is likely to increase. This will result in states having more discretion in the kinds of services that are ultimately funded. Interest rates remained steady, resulting in not-for-profit organizations receiving steady levels of return on their interest-earning investments. Significant increases in equity markets have resulted in higher returns on equity investments, resulting in many organizations earning significant returns on their total investment portfolios. Exhibit 1 summarizes the changes in key economic factors from last year.

Exhibit 1

| <i>Economic Factor</i> | <i>Change From Last Year</i> |
|--------------------------|---|
| Private Contributions | Information not available. (Increases are expected to outpace inflation.) |
| Interest Rates | Steady |
| Corporate Contributions | Increase (5 percent to 7.5 percent) |
| Equity Markets | Significant Increase |
| Funding from Foundations | Significant increase. (Some surveys say as high as 16 percent) |
| Government Funding | Steady |

The use of gifts, such as annuities, charitable remainder annuity trusts and unitrusts, pooled income funds, and lead trusts, that provide donors with tax deductions while retaining beneficial interests in property continues to increase. Not-for-profit organizations that receive those gifts are faced with the challenge of maintaining the invest-

ment assets at sufficient levels to support the required payments to donors and beneficiaries. The recently issued AICPA Audit and Accounting Guide *Not-for-Profit Organizations*, which is discussed in the *AICPA Guide Project* section of this Audit Risk Alert, provides new guidance concerning accounting for those gifts. Auditors should consider whether organizations' accounting for those gifts are appropriate and consistently applied.

The media continue to focus attention on issues relating to not-for-profit organizations, including the following:

- Reasonableness of compensation
- Fringe benefits
- Perquisites afforded to the senior management personnel of some organizations
- Conflicts of interest arising from transactions with members of the board of trustees and other insiders
- Lobbying activities
- The perception that expenditures for program services are too low as a percentage of total expenditures
- Fraud and abuse
- The amounts of assets held by not-for-profit organizations
- The portion of revenue earned from fees for goods or services
- Whether activities undertaken by the organization are consistent with its exempt purpose
- Contractual compliance and excess revenues related to government sponsored or funded programs

The adverse publicity concerning such issues continues to adversely affect the amounts some donors are willing to contribute. Furthermore, the excess benefits of executives may have the following consequences:

- The imposition of fines on the organization by the Internal Revenue Service (IRS) under recently enacted intermediate sanctions, which are discussed in the *IRS Activities* section of this Audit Risk Alert
- Jeopardizing the tax-exempt status of the organizations they serve

Changes in funding as well as increased scrutiny continue to exert pressure on not-for-profit organizations to maximize investment returns and to present financial statements that make their operations appear as efficient as possible. Auditors should consider the effect that such pressures may have on audit risk, particularly those associated

with areas such as (1) allocation of costs between program services and support services and (2) potentially high-risk investments, such as certain derivatives and equity instruments.

Like many organizations, some not-for-profit organizations are restructuring and reengineering their operations to become more efficient. Auditors should consider the effects of such restructuring and reengineering on their consideration of internal controls, as well as considering whether such charges are reported in conformity with generally accepted accounting principles (GAAP).

Regulatory and Legislative Developments

Major Changes to Single Audits of Federal Awards

The promise of major change in single audit policy became a reality during 1996. These changes continue to be finalized during the first half of 1997. Auditors performing audits of federal awards should follow developments in this area closely to ensure that the appropriate guidance is followed. The sections below summarize four key pieces of guidance which have been or are currently being revised for single audits and program-specific audits of federal awards. The latter three, U.S. Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, the *Compliance Supplement*, and the AICPA Statement of Position, were not completed at the time of publication of this Audit Risk Alert. Information on the status of these documents will be published in the *Journal of Accountancy* and *The CPA Letter* and will be made available on the AICPA Fax Hotline and home page (<http://www.aicpa.org>).

Single Audit Act Amendments of 1996 (1996 Amendments). On July 5, 1996, President Clinton signed into law legislation amending the Single Audit Act of 1984 (Public Law 104-156), which is effective for fiscal years beginning after June 30, 1996. The 1996 Amendments extend the act's jurisdiction to not-for-profit organizations, raise the dollar threshold for audit coverage to \$300,000 from \$25,000, implement a risk-based approach to identify the major federal programs to be audited, and shorten the audit report due date to nine months after a transition period of two years. The 1996 Amendments are discussed further in a November 1996 *Journal of Accountancy* article entitled "Auditing Federal Awards, A New Approach." A copy of the 1996 Amendments is also available on the AICPA Fax Hotline; dial (201) 938-3787 from a fax machine and select document number 402. The full text of the amendments is located on IGnet at <http://www.sbaonline.sba.gov/ignet/> under the listing "Single Audit."

OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. A revised OMB Circular A-133, applicable only to not-for-profit organizations, was issued on April 22, 1996. Once the 1996 Amendments were passed (see above), it became necessary for the OMB to propose another revision to OMB Circular A-133 to add states and local governments to the scope of the Circular and to comply with certain other aspects of the 1996 Amendments. This proposed revision was issued in the November 5, 1996, *Federal Register* (61FR 57231), and a final document is expected to be issued before June 30, 1997. The OMB intends to rescind Circular A-128, *Audits of State and Local Governments*, which is the existing regulation governing audits of federal awards for states and local governments once OMB Circular A-133 is issued in final form.

Once finalized, OMB Circular A-133 will establish audit requirements that apply to not-for-profit organizations (including hospitals and colleges and universities) and state, local, and Indian tribal governments, and will be effective for fiscal years beginning after June 30, 1996. Provisions of the revised Circular include the following.

- The threshold for audit is raised to \$300,000 from \$25,000.
- Auditors are required to identify major programs on the basis of a risk assessment, considering prior audit experience, oversight performed by federal agencies and others, and the inherent risk of the program, rather than solely on the basis of federal expenditures. Due to the timing of the issuance of the final Circular and related audit guidance, auditors may want to consider a provision in the Circular that allows auditors to determine major programs solely on the basis of federal expenditures for first year audits. First year audits are defined as the first year that an entity is audited under the new Circular or the first year of a change of auditors. As an example, if an auditor has a client with a June 30, 1997, fiscal year end, the use of the risk-based approach to determine major programs would be optional for that year because it would be the first audit under the new Circular.
- Major program coverage is required to be a minimum of 50 percent (or 25 percent for low-risk auditees) of the federal awards expended.
- The required level of testing of internal control over major programs is clarified as being based on auditors' planning for a low assessed level of control risk.
- Guidance is included for conducting program-specific audits covering those situations in which a federal grantor agency has not issued a program-related audit guide, as well as those situations in

which a program-specific audit guide has been issued by the grantor agency.

- Minimum requirements for the Schedule of Expenditures of Federal Awards are provided.
- Guidance is included concerning the following:
 1. Reporting audit findings in a single schedule of findings and questioned costs which includes a summary of the audit results, and findings and questioned costs related to the financial statement audit as well as to federal awards
 2. Thresholds for determining which audit findings should be included in the schedule of findings and questioned costs
 3. Descriptions of what information auditors should include in an audit finding
 4. Required follow-up on audit findings
- Auditee management is required to provide a corrective action plan for current year audit findings and a summary schedule reporting the status of prior year audit findings.
- The definition of *nonprofit organization* is revised to include non-profit hospitals.
- Restrictions are imposed on auditor selection whereby auditors who also prepare the indirect cost proposal or cost allocation plan are prohibited from being selected as the auditor if the indirect costs recovered in the prior year are greater than \$1 million in total. This provision is not effective until audits of fiscal years beginning after June 30, 1998.
- The due date is shortened for submitting reports to nine months from thirteen months, after a two-year transition period. The transition period is for fiscal years beginning on or before June 30, 1998, during which auditees will have thirteen months after the end of the audit period to complete the audit and submit the reporting package. The provision for a cognizant or oversight agency to grant an extension is retained. Also the report submission process is streamlined, including incorporating a data collection form, and expanding the role of the federal clearinghouse.

Auditors should note that the November 1996 proposed revisions to OMB Circular A-133 included two significant changes from the earlier revision concerning the data collection form and audit coverage of indirect cost pools. In summary, the proposal would require auditors to prepare and sign the data collection form, and test and report on the

allowability of costs charged to cost pools. Because the final resolution of these issues is unknown at this time, auditors should carefully review the final Circular for any new requirements.

As noted in the preceding paragraphs, the 1996 Amendments are effective for fiscal years beginning after June 30, 1996, and OMB expects to issue the revised OMB Circular A-133 before June 30, 1997. OMB will instruct federal agencies to adopt OMB Circular A-133 in codified regulations within six months after publication of the final OMB Circular A-133 in the *Federal Register* so that it will apply to audits of fiscal years beginning after June 30, 1996. Therefore, the revised OMB Circular A-133 should be followed for audits of years beginning after June 30, 1996. Until such time as OMB publishes the final revision of OMB Circular A-133, auditors are encouraged to use the revision of OMB Circular A-133 published in the November 5, 1996 *Federal Register* for planning purposes.

Last, as a result of the issuance of the 1996 Amendments and revisions to OMB Circular A-133, questions have arisen with regard to the status of position statements issued by the President's Council on Integrity and Efficiency (PCIE). These position statements were originally developed to address issues related to audits conducted under the Single Audit Act of 1984, OMB Circular A-128, and the March 1990 version of OMB Circular A-133. Therefore, with the exception of PCIE Statement No. 4, none of the remaining position statements is applicable to audits conducted under the 1996 Amendments or the new OMB Circular A-133 requirements.

Upon publication, a copy of the final revision to OMB Circular A-133 may be obtained from the *Federal Register*; the OMB fax information line (202) 395-9068, document number 1133; the OMB home page on the Internet, which is currently located at <http://www.whitehouse.gov/WH/EOP/OMB/html/ombhome.html>; or by calling or writing the Office of Administration, Publications Office, Room 2200, New Executive Office Building, Washington, DC 20503, telephone (202) 395-7332.

Compliance Supplement. A revised OMB Compliance Supplement which is currently under development will set forth the material compliance requirements that are to be included in an audit in accordance with OMB Circular A-133. It will cover states, local governments, and not-for-profit organizations. The OMB is expected to issue a Provisional Compliance Supplement before June 30, 1997, to replace the existing Compliance Supplements entitled *Compliance Supplement for Single Audits of State and Local Governments* (issued in September 1990) and *Compliance Supplement for Institutions of Higher Learning and Other Non-Profit Institutions* (issued in October 1991), which are no longer

current. It is expected that a notice will be provided in the *Federal Register* of the Provisional Supplement's availability along with a request for public comment. Auditors should use the Provisional Supplement until the public comment process is completed and OMB issues a Final Supplement. OMB anticipates issuing a Final Supplement in 1998.

The most significant changes to the revised Compliance Supplement will include the following:

- A compliance matrix, which provides an overview of the compliance requirements applicable to the programs listed in the supplement
- Replacement of the classifications of general requirements and specific requirements with the following fourteen types of compliance requirements, all of which are covered by the auditor's opinion on compliance:

- Activities Allowed or Unallowed
- Allowable Costs/Cost Principles
- Cash Management
- Davis-Bacon Act
- Eligibility
- Equipment and Real Property Management
- Matching, Level of Effort, Earmarking
- Period of Availability of Federal Funds
- Procurement and Suspension and Debarment
- Program Income
- Real Property Acquisition and Relocation Assistance
- Reporting
- Subrecipient Monitoring
- Special Tests and Provisions

- Audit objectives and suggested audit procedures for each type of compliance requirement
- Expanded guidance on allowable costs and cost principles, which includes a comparison of the requirements between the common rule, OMB Circular A-21, *Cost Principles for Educational Institutions*; and OMB Circular A-122, *Cost Principles for Non-Profit Organizations*
- Detailed guidance on how to determine applicable compliance requirements, control objectives, and audit objectives for programs not listed in the Compliance Supplement
- Characteristics of internal control over compliance are presented in the format included in *Internal Control—Integrated Framework*

(the COSO Report), published by the Committee of Sponsoring Organizations of the Treadway Commission

Initially, the Provisional Supplement will include approximately twenty-five federal programs. This is far less than what was included in the Compliance Supplements that are being replaced. However, the OMB has made a commitment to continue working on the Provisional Supplement and to include additional programs in the Final Supplement. As noted above, the OMB will be adding guidance to the Compliance Supplement that instructs auditors on the appropriate steps to take when a program is not included. The Compliance Supplement will be available from the Government Printing Office (See the table under the section of this Audit Risk Alert entitled "Information Sources" for information on how to contact the Government Printing Office) and the OMB home page on the Internet, which is currently located at <http://www.whitehouse.gov/WH/EOP/OMB/html/ombhome.html>. Once the supplement has been issued, more detailed guidance on how to obtain copies will be included in the AICPA's *CPA Letter* and posted on the OMB and AICPA home pages.

AICPA Statement of Position. With the changes described in the preceding three sections, Statement of Position 92-9, *Audits of Not-for-Profit Organizations Receiving Federal Awards*, and certain sections of the Audit and Accounting Guide *Audits of State and Local Governmental Units* (the Guide) have become outdated. In response, the AICPA is in the process of developing a new SOP that will supersede SOP 92-9 and the sections of the Guide that are outdated. The new SOP is expected to be issued during the summer of 1997 (assuming that the previously described OMB guidance is issued on the dates planned) and will provide auditors of states, local governments, and not-for-profit organizations with guidance on the work performed and the reports issued for audits under the 1996 Amendments, and OMB Circular A-133. It will also include revised simplified illustrative audit reports. The new illustrative simplified reports will include one report on the financial statements, one report that will meet the requirements for reporting on compliance and internal control under *Government Auditing Standards* (GAS, also known as the Yellow Book), and one report that will meet the requirements of the 1996 Amendments and OMB Circular A-133 for reporting on single audits of federal awards.

OMB Circulars A-21 and A-122

Auditors involved with audits of federal awards for colleges and universities should be aware that the OMB issued revisions to OMB

Circular A-21 in May 1996 (*Federal Register*, May 8, 1996) which are effective for fiscal years beginning after May 8, 1996. The revisions incorporate four cost accounting standards issued by the Cost Accounting Standards Board (CASB) applicable to all sponsored agreements subject to OMB Circular A-21 and extend the applicability of the CASB disclosure statement to universities that receive more than \$25 million in federally funded sponsored agreements. It also amends the definition of equipment; eliminates the use of special cost studies to allocate utility, library, and student services costs (effective for fiscal years beginning on or after July 1, 1998); requires the use of fixed facilities and administrative cost rates for the life of sponsored agreements; establishes cost negotiation cognizant agency responsibilities; clarifies the policy for a change from use allowance to depreciation; adds criteria to interest allowability; and disallows tuition benefits for employee family members for fiscal years beginning on or after September 30, 1998. In performing audits in accordance with OMB Circular A-133, auditors should consider whether organizations subject to OMB Circular A-21 have complied with the CASB standards and disclosure requirements incorporated therein.

In October 1995, OMB published proposed revisions to OMB Circular A-122. The proposed revisions would change the definition of equipment, make certain additional costs unallowable, modify the multiple allocation based method for computing indirect cost rates, and place a 26 percent ceiling on the administrative portion of indirect costs for organizations with federal funding over \$10 million. The proposed changes would provide consistency among OMB Circulars for not-for-profit organizations, state and local governments, and educational institutions. The period for commenting on the proposal has expired and the final revision is expected to be issued in October 1997.

U.S. Department of Education Issues New Drawdown Procedures for Grant Payments

Auditors with clients that receive grants from the U.S. Department of Education should be aware of changes in the procedures for grant payments accounting and reporting. A letter was issued in July 1996, notifying program recipients of the new drawdown procedures to take effect in 1997 between July and September. The fundamental change is that recipients will have to request Department of Education dollars by individual program when drawdowns are made. In the past, recipients were allowed to pool their drawdowns into a single amount without identifying the specific programs being funded. The new procedure may require many recipients to change their internal processes and systems. Auditors should consider this change when testing cash man-

agement in conjunction with single audits. Contact Charles L. Coleman, Director of Cash Management, U.S. Department of Education, for further information at (202) 401-1776.

Audit Quality

The AICPA and the President's Council on Integrity and Efficiency (PCIE) are involved in a cooperative effort in which Federal Inspectors General (IGs) of government agencies refer to the AICPA Professional Ethics Division audits of entities receiving federal awards that the IGs consider to be of a substandard nature. Also, the PCIE issues periodic reports on the results of IG desk reviews and quality control reviews of work performed by independent auditors. Information gathered during these investigations about the most common deficiencies can be useful to auditors when undertaking, planning, and conducting audit engagements of entities receiving federal awards. Some of the more common deficiencies cited by reviewers include—

- Deficient audit reports (incorrect reports on internal control or compliance, not all required information included, incorrect presentation of financial information without proper qualification, improper or missing opinion, incorrect or missing findings, no disclosure of reportable conditions)
- Inadequate working papers (failure to adequately support opinion, no documentation of required procedures such as internal control evaluation, analytical procedures, or subsequent events review)
- Failure to perform all procedures required in agency audit guide or compliance supplement (no compliance testing, no study and evaluation of internal control)

The risks and ramifications to auditors of issuing deficient audit reports or performing inadequate audits are significant. AICPA-required corrective actions and sanctions can include mandatory CPE in specified subjects, mandatory work product preissuance reviews, preclusion from performing quality reviews, and suspension or expulsion from the AICPA and state CPA society. Substandard audit work can also result in actions by state boards of accountancy such as fines and loss of license or certification.

Other Federal Issues

Business-Related Activities. Some businesses believe that tax-exempt not-for-profit organizations have unfair competitive advantages over taxable entities and have asked the U.S. Congress to pass laws to elimi-

nate those perceived advantages. Such laws could adversely affect some not-for-profit organizations, although their passage does not appear imminent.

Work Opportunity Reconciliation Act and Health Care Reform Issues. In August 1996, the federal government passed the Personal Responsibility and Work Opportunity Reconciliation Act (Public Law 104-193) to overhaul the welfare system. Beginning October 1, 1996, states gained broad authority over their own welfare programs, and the form of federal funding was changed to block grants, giving the states flexibility in determining who is eligible for the funds. On an overall basis, the law is expected to reduce the amount of government funds expended for welfare per person. As a result, not-for-profit organizations that provide programs to serve the homeless, immigrants, the poor, and others who may be adversely affected by the overhaul may receive pressure to increase their levels of service. Some are responding to that pressure by changing the ways in which they raise funds, and operate and deliver services.

Similarly, continued state wide initiatives to move health care services (physical care as well as behavioral care) to managed care arrangements are creating opportunities as well as challenges to some organizations. These organizations must assess changes to their service delivery systems and funding mechanisms but are also identifying opportunities to provide new services or to serve new populations.

Auditors should consider the effects of these changes on their consideration of internal control and on the organization's compliance with applicable laws and regulations.

Also, some organizations may be motivated to increase their lobbying activities at the state level as they compete for funds. Auditors should consider whether those activities are in accordance with IRS restrictions on lobbying activities.

In addition, the act eases restrictions that religious organizations may face in establishing eligibility for federal funds. As a result, some religious organizations may receive increased government funds and may also be subjected to increased audit and compliance requirements. For example, the organization may be required to have an audit performed in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States or in accordance with OMB Circular A-133. Auditors should consider whether the organization has complied with applicable laws and regulations. Paragraphs 21 to 23 of Statement on Auditing Standards (SAS) No. 74, *Compliance Auditing Considerations in Audits of Governmental Entities and Recipients of Governmental Financial Assistance* (AICPA, *Professional Standards*, vol. 1, AU sec. 801), provide guidance on the auditor's responsibilities if he

or she becomes aware that the entity is subject to an audit requirement that may not be encompassed in the terms of the engagement. SAS No. 74 provides that, in that situation, "the auditor should communicate to management and the audit committee, or to others with equivalent authority and responsibility, that an audit in accordance with generally accepted auditing standards may not satisfy the relevant legal, regulatory, or contractual requirements." SAS No. 74 also notes that "the auditor should consider how the client's actions in response to such communication relate to other aspects of the audit, including the potential effect on the financial statements and on the auditor's report on those financial statements. Specifically, the auditor should consider management's actions (such as not arranging for an audit that meets the applicable requirements) in relation to the guidance in SAS No. 54 [*Illegal Acts By Clients* (AICPA, *Professional Standards*, vol. 1, AU sec. 317)]."

Philanthropy Protection Act of 1995. The Philanthropy Protection Act of 1995, which took effect March 6, 1996, exempts charitable gift annuities, charitable remainder unitrusts, charitable remainder annuity trusts, and other kinds of split-interest agreements that will be commingled for investment purposes from the Investment Company Act and other securities laws. Also, it requires organizations to make certain written disclosures about the terms of the operations of the fund to potential contributors. Auditors should consider whether organizations have made the disclosures required by the act.

New Postal Rates. In October 1996, the U.S. Postal Service changed its rate structure for not-for-profit organizations. The Postal Service estimates that the changes will save organizations an average of 6.4 percent for each piece of mail they send, though rates will increase for certain kinds of mail, such as mail that is neither sorted according to certain specifications, delivered to local postal facilities, nor bar coded. Auditors should consider the effects of such changes when performing their analytical procedures and other substantive tests of expenses.

State and Local Issues

State and local laws concerning not-for-profit organizations continue to change. Some states have enacted or are revising existing laws concerning not-for-profit registration or licensing requirements; annual reporting requirements; charitable solicitation, registration, and disclosure requirements; charitable gift annuity registrations; and limitations on fund-raising expenses. Also, some states have increased efforts to have not-for-profit organizations pay property taxes, collect and remit

sales and use taxes, or make other payments in lieu of such taxes. The American Association of Fund-Raising Counsel, Inc. (AAFRC) publishes its *Annual Survey of State Laws Regulating Charitable Solicitations* (available for \$24). Copies of this publication can be obtained by writing to the AAFRC, Suite 820, at 25 West 43d Street, New York, NY 10036, or by calling (212) 354-5799.

IRS Activities

Auditors should be aware of applicable tax laws and regulations and their potential impact on not-for-profit organizations and their financial statements. An organization's failure to maintain its tax-exempt status could have serious tax consequences and affect both its financial statements and related disclosures, and it could possibly require modification of the auditor's report. Failure to comply with tax laws and regulations could be an illegal act that may have either a direct and material effect on the determination of financial statement amounts. Examples include the result of an incorrect accrual for taxes on unrelated business income (UBI) or a material indirect effect on the financial statements that would require disclosures, such as the result of a potential loss of tax-exempt status. SAS No. 54 discusses the nature and extent of the consideration the auditor should give to the possibility of illegal acts and provides guidance on the auditor's responsibilities when a possible illegal act is detected.

Intermediate Sanctions and Other Matters. On July 30, 1996, the Taxpayer Bill of Rights (HR 2337) was enacted into law. This law allows the IRS to impose harsh penalties on insiders and managers of section 501(c)(3) and section 501(c)(4) organizations in certain circumstances related to excess benefit transactions. Under the new law, disqualified persons who unjustly benefit from an organization are subject to a first-tier penalty excise tax of 25 percent of the excess benefit amount. Also, organization managers who knowingly participate in an excess benefit transaction are subject to an excise tax of 10 percent. Further, taxes may be imposed on disqualified persons who do not correct the transaction by undoing the excess benefit to the extent possible.

An *excess benefit transaction* is a transaction in which an economic benefit is provided to or for the use of any disqualified person if the value of the economic benefit provided directly by the organization exceeds the value of the consideration received by the organization. Also included is any transaction in which the amount of any economic benefit provided to any disqualified person is determined by the revenues of the organization, provided the transaction constitutes prohibited inurement under the present law. A *disqualified person* is any

individual who is in a position to exercise substantial influence over the affairs of the organization, whether by being an organization manager or otherwise. Also included are certain family members and 35-percent-owned entities of a disqualified person, as well as anyone who was a disqualified person at any time during the five-year period prior to the transaction at issue. An *organization manager* is an officer, director, trustee or anyone who has the power or authority of an officer, director, or trustee.

In general, intermediate sanctions are effective for excess benefit transactions occurring on or after September 14, 1995. However, they do not apply to transactions occurring pursuant to a written contract that was binding on September 13, 1995, and at all times thereafter before such benefits arose, and the terms of which have not materially changed. The Treasury Department and the IRS will likely issue regulations and provide guidance for interpretations of these provisions.

Congress is considering expanding the provisions concerning excess benefit transactions to other tax-exempt organizations, such as those under section 501(c)(5) (for example, labor unions) and those exempt under section 501(c)(6) (for example, business leagues), but further action is not imminent.

Also, under this law, all tax-exempt organizations must provide copies of their three most recent annual information returns and application for exemption from tax to the general public. Specifically, if the request is made in person, a copy must be made available immediately, with certain exceptions, such as if the requested documents have been made widely available to the public. If not made in person, a copy must be provided within 30 days. The organization may charge a reasonable fee for copying and mailing costs. The penalty for failure to furnish a requested information return or exemption application is \$10 for each day during which such failure continues, with a \$5000 limit on the return penalty and no limit on the exemption application penalty.

The rules concerning the annual information return and application for exemption from tax to the general public will not go into effect until 60 days after regulations to implement them have been issued.

On September 12, 1996, the IRS issued a notice in which they requested comments in drafting future guidance. In particular, comments were requested concerning ways in which the organization can make relevant documents widely available.

Eligibility as an S Corporation Shareholder. For tax years beginning after 1997, qualified charities and certain retirement plans will be eligible to be S corporation shareholders. Currently, and until 1998, the contribution of voting or nonvoting S corporation stock to either of these entities would have terminated the S election for the business.

The not-for-profit organization must treat the shares of the S corporation as an interest in an unrelated trade or business. Therefore, the items of income, loss, deduction, or credit that flow through to the tax-exempt shareholder and gain or loss on the sale of the stock will be treated as UBI. This characterization of the income and loss as UBI applies regardless of the nature of the income actually passed through. Therefore, interest income (ordinarily excluded from UBI due to its passive nature) will be treated as UBI.

Increased Penalties for Failure to File Form 990. The penalty for failure to file timely or complete returns for small tax-exempt organizations has been increased from \$10 to \$20 per day, with a maximum fine of the lesser of \$10,000 or five percent of the organization's gross receipts. Large organizations (those having gross receipts exceeding \$1 million) are subject to a penalty of \$100 per day, with a maximum of \$50,000. No penalty will be imposed if an organization can show that the failure to file a complete return was due to reasonable cause. This provision applies to returns for taxable years ending on or after July 30, 1996.

Establishing 401(K) Plans. Since 1986, tax-exempt organizations have been prohibited from establishing 401(k) plans. Therefore, many section 501(c)(3) and governmental education organizations established 403(b) plans that provide employees with the ability to defer wage income into annuity investments. Under the recent tax bill, all tax-exempt organizations are once again permitted to establish 401(k) plans. This provision is effective for plan years beginning after December 31, 1996.

Unrelated Business Income Taxes. If UBI taxes are material to the financial statements, they must be accrued. Auditors should consider the following developments in determining whether liabilities for taxes are properly reported:

- *Taxability of affinity and rental revenue from mailing lists.* The 9th Circuit Court of Appeals ruled that income from the rental of the Sierra Club's mailing list, which was used in connection with an affinity program, is nontaxable royalty income because the revenue represents payments for the right to use intangible property. The Sierra Club did not actively participate in the rental of its list but instead engaged an unrelated mailing list broker, who paid royalties to the club.

However, the Court refused to agree that all of the club's income from the affinity program constituted exempt royalties. As a result, the issue of whether the club's affinity program

income is fully nontaxable has been remanded to the Tax Court for additional tax finding. The IRS will continue to pursue this issue.

- *Administrative services.* The IRS recently issued two identical rulings concerning fees earned by an exempt fraternal organization in exchange for its performance of administrative services for closely related exempt organizations. The fraternal organization charged the lower of its cost or market for its services, and expense allocations were reviewed by the related exempt organization's board of directors. The IRS ruled that due to the close control relationship between the entities, the services should be considered to contribute to the fraternal organization's exempt purpose. Accordingly, the charge for administrative services will not be subject to UBIT.
- *Instant bingo.* In an appeal from the Tax Court, the 5th Circuit Court of Appeals recently confirmed that what is commonly called *instant bingo* (or *pull tab bingo*) is not bingo for tax purposes. Thus, at least in the 5th Circuit, income from instant bingo cannot avoid UBI tax using the statutory exception for bingo. However, the organization involved in the case would have avoided tax on the income if it either had used volunteers to run the activity or had conducted it on an irregular basis.
- *Museum activities.* A recently released Technical Advice Memorandum (TAM 9550003) focuses on the taxability of various activities undertaken by museums. It provides insight concerning the current thinking of the IRS on a number of UBI issues regularly faced by museums.

Taxable Subsidiaries. The IRS recently issued Private Letter Ruling (PLR) number 9542045, which discusses several issues concerning taxable subsidiaries of tax-exempt entities, such as potential taxation on formation, the requirement to maintain operations that are separate from the operations of the tax-exempt entity, and factors to consider concerning section 512(b)(13) in order to avoid unrelated business income on royalty payments. Also, the Treasury has released proposed regulation 1.337(d)-4 under section 337(d). Under the proposed regulations, if a taxable corporation transfers all or substantially all of its assets to one or more tax-exempt entities, the taxable corporation must recognize gain or loss as if the assets transferred were sold at fair market value. This can also apply if the taxable corporation changes its status to tax-exempt. Proposed regulations are effective thirty days after publication as final regulations. Similar treatment applies under section 337 (b)(1) on a liquidation of a taxable corporation into an exempt parent organization.

Tax-Sheltered Annuity Voluntary Correction (TVC) Program Extended. The IRS's TVC program, which began in 1995, gives plan sponsors of section 403(b) annuity plans the opportunity to voluntarily correct any plan defects. The program was scheduled to conclude October 1996. However, the IRS has recently announced that the program has been extended until December 31, 1998. Use of the TVC program may result in significantly reduced settlements with the IRS, compared to assessments based on deficiencies discovered during audits performed by the IRS.

Based on past IRS audit experience, thousands of exempt organizations are believed to have defective plans. But, as of July 15, 1996 only 31 had taken advantage of the TVC program. The IRS has speculated that employers are awaiting to see how harshly the penalties are being applied. The IRS proposed examination guidelines were included in Announcement 96-25, 1996-17 Internal Revenue Bulletin No. 1.

Lobbying Disclosure Act of 1995. The Lobbying Disclosure Act of 1995 requires organizations that lobby to register and report their federal lobbying activities. The act includes definitions of lobbying activities, including exemptions for organizations spending less than \$20,000 on lobbying activities during a semiannual reporting period, and for religious organizations exempt from filing tax returns. Organizations meeting certain requirements must register with the U.S. Congress and file semiannual reports no later than February 14 and August 14 of each year. Failure to comply with the provisions of the act may result in civil penalties up to \$50,000.

Audit Issues and Developments

Internal Control

Changes in financial accounting standards, increased attention to the requirements to properly bill overhead costs to government agencies, restructuring, increased participation in affinity programs or similar arrangements, and expanded contractual audit requirements are resulting in the need for significant changes in the accounting systems and internal control of not-for-profit organizations. In addition, as the overall economy improves, competition for qualified staff increases and not-for-profit organizations, which tend to pay lower salaries than for-profit entities, may have difficulty retaining well qualified staff, which may result in changes in internal control. Auditors should ensure that they have a sufficient understanding of the organization's internal control in order to plan and perform the audit. As discussed in the *Auditing Pronouncements* section of this Audit Risk Alert, in Decem-

ber 1995, the AICPA's Auditing Standards Board (ASB) issued SAS No. 78, *Consideration of Internal Control in a Financial Statement Audit: An Amendment to Statement on Auditing Standards No. 55* (AICPA, *Professional Standards*, vol. 1, AU sec. 319), which discusses the auditor's consideration of internal control in a financial statement audit.

Affinity Programs and Other Affiliations. Some entities, including some operating on the Internet, offer not-for-profit organizations fundraising opportunities through various arrangements, such as affinity programs and investment networks. Some of those arrangements may be fraudulent, such as those that are actually investment pyramids, and organizations associated with them may be committing illegal acts. SAS No. 54 discusses the nature and extent of the consideration that auditors should give to the possibility of illegal acts and provides guidance on the auditor's responsibilities if a possible illegal act is detected.

Some affinity programs or other arrangements offer organizations royalties or other income in exchange for using the organization's name or logo. Auditors should consider internal controls over revenue earned and received under such arrangements.

Auditing Pronouncements

Exhibit 2 summarizes six new Statements on Auditing Standards that have been recently issued.

Exhibit 2

| Pronouncement | Pronouncements Affected | Key Provisions | Effective Date |
|---|-------------------------|--|---|
| SAS No. 77, <i>Amendments to Statement on Auditing Standards No. 22, Planning and Supervision, No. 59, The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern, and No. 62, Special Reports</i> (AICPA, <i>Professional Standards</i> , vol. 1, AU secs. 311, 341, and 623) | SAS Nos. 22, 59, and 62 | Clarifies that a written audit program should be prepared; precludes the use of conditional language in a going concern report | The Statement is effective for engagements beginning after December 15, 1995. |

| <i>Pronouncement</i> | <i>Pronouncements Affected</i> | <i>Key Provisions</i> | <i>Effective Date</i> |
|---|--------------------------------|---|---|
| SAS No. 78, <i>Consideration of Internal Control in a Financial Statement Audit: An Amendment to Statement on Auditing Standards No. 55</i> (AICPA, <i>Professional Standards</i> , vol. 1, AU sec. 319A) | SAS No. 55 | Recognizes the COSO definition of internal control | The Statement is effective for audits of financial statements for periods beginning on or after January 1, 1997, with earlier application encouraged. |
| SAS No. 79, <i>Amendment to Statement on Auditing Standards No. 58, Reports on Audited Financial Statements</i> (AICPA, <i>Professional Standards</i> , vol. 1, AU sec. 508) | SAS No. 58 | Eliminates the requirement to add an uncertainties paragraph to the auditor's report (does not affect SAS No. 59, <i>The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern</i> (AICPA, <i>Professional Standards</i> , vol. 1, AU sec. 341) | The Statement is effective for reports issued on or after February 29, 1996, with earlier application permitted. |
| SAS No. 80, <i>Amendment to Statement on Auditing Standards No. 31, Evidential Matter</i> (AICPA, <i>Professional Standards</i> , vol. 1, AU sec. 326) | SAS No. 31 | Provides guidance for audits in which significant information is transmitted, processed, maintained, or accessed electronically | The Statement is effective for engagements beginning on or after January 1, 1997. |
| SAS No. 81, <i>Auditing Investments</i> (AICPA, <i>Professional Standards</i> , vol. 1, AU sec. 332.) | SAS No. 1 | Revises the guidance on auditing investments to make that guidance consistent with recently issued | The Statement is effective for audits of financial statements for periods ending on or after December 15, 1997. |

(continued)

| <i>Pronouncement</i> | <i>Pronouncements Affected</i> | <i>Key Provisions</i> | <i>Effective Date</i> |
|---|--------------------------------|---|---|
| | | accounting standards, particularly FASB Statements No. 115 and 124 | |
| SAS No. 82, <i>Consideration of Fraud in a Financial Statement Audit</i> (AICPA, <i>Professional Standards</i> , vol. 1, AU sec. 316) | SAS No. 53 | Provides expanded guidance on the consideration of fraud in conducting a financial statement audit. | The Statement is effective for audits of financial statements for periods ending on or after December 15, 1997. |

SAS No 77. In November 1995, the ASB issued SAS No. 77, which, among other things, clarifies that a written audit program should be prepared in every audit and precludes the use of conditional language in the auditor's explanatory paragraph to indicate that there is substantial doubt about the entity's ability to continue as a going concern. SAS No. 77 is effective for engagements beginning after December 15, 1995.

SAS No. 78. In December 1995, the ASB issued SAS No. 78, which revises the definition and description of internal control contained in the Statements on Auditing Standards to recognize the definition and description contained in the COSO Report. This Statement is effective for audits of financial statements for periods beginning on or after January 1, 1997, with earlier application permitted.

SAS No. 79. In December 1995, the ASB issued SAS No. 79, which eliminates the requirement that, if certain criteria are met, the auditor add an uncertainties explanatory paragraph to the auditor's report. SAS No. 79 also clarifies and reorganizes the guidance in SAS No. 58 concerning emphasis paragraphs, matters involving uncertainties, and disclaimers of opinion. This SAS neither affects SAS No. 59 nor precludes the auditor from adding a paragraph to the auditor's report to emphasize a matter disclosed in the financial statements. This Statement is effective for reports issued or reissued on or after February 29, 1996, with earlier application permitted. Auditors are permitted to delete the uncertainties paragraph in their audit reports for year end audits.

SAS No. 80. In December 1996, the ASB issued SAS No. 80. This Statement amends SAS No. 31 to recognize that evidential matter may

exist only in electronic form. It also provides guidance to auditors engaged to audit the financial statements of entities for which significant information is transmitted, processed, maintained or accessed electronically.

SAS No. 80 recognizes that, in certain entities, some of the accounting data and corroborating evidential matter are available only in electronic form. Source documents such as purchase orders, bills of lading, invoices, and checks might be replaced with electronic messages. In image processing systems, source documents are scanned and converted into electronic images to facilitate storage and reference, and the source documents may not be retained after conversion. SAS No. 80 also states that, in entities in which significant information is transmitted, processed, maintained, or accessed electronically, the auditor may determine that it is not practical or possible to reduce detection risk to an acceptable level by performing only substantive tests for one or more financial statement assertions. For example, the potential for the improper initiation or alteration of information to occur and not be detected may be greater if information is produced, maintained, or accessed only in electronic form. In such circumstances, the auditor should perform tests of controls to gather evidential matter to use in assessing control risk, or consider the effect on his or her report. SAS No. 80 is effective for engagements beginning on or after January 1, 1997.

SAS No. 81. In December 1996, the ASB issued SAS No. 81, which supersedes AU sec. 332, *Long Term Investments*, which was included in SAS No. 1. The Statement revises the guidance on auditing investments to make that guidance consistent with recently issued accounting standards, particularly FASB Statements No. 115, *Accounting for Certain Investments in Debt and Equity Securities* and 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*. The Statement includes guidance on auditing assertions about the valuation of investments, including guidance on auditing investments carried at cost and fair value. The guidance in SAS No. 81 regarding investments accounted for using the equity method of accounting is generally unchanged from the guidance contained in the previous standard. SAS No. 81 is effective for audits of financial statements for periods ending on or after December 15, 1997, with early application permitted.

SAS No. 82. In February 1997, the ASB issued SAS No. 82. The new Statement will supersede SAS No. 53, *The Auditor's Responsibility to Detect and Report Errors and Irregularities* (AICPA, *Professional Standards*, vol. 1, AU sec. 316). SAS No. 82 provides auditors with expanded guidance on the consideration of fraud in conducting a financial statement

audit. It strengthens the auditor's ability to fulfill his or her responsibility to plan and perform the audit in order to obtain reasonable assurance about whether the financial statements are free of material misstatements, whether caused by error or fraud.

The new Statement describes the types of fraud and requires auditors to specifically assess the risk of material fraud in every audit. It also provides separate categories of risk factors for fraudulent financial reporting (management fraud) and misappropriation of assets (theft) that require consideration.

In addition, the new Statement provides procedural guidance and examples of how auditors can respond to the presence of fraud risk factors. The new Statement reaffirms the requirement that auditors communicate known instances of fraud to appropriate levels of management and the audit committee and, under certain circumstances, appropriate regulators.

The new Statement is effective for audits of financial statements for periods ending on or after December 15, 1997.

The AICPA is undertaking a major initiative to assist auditors in understanding and implementing SAS No. 82. Implementation efforts include the following:

- A Practice Aid entitled, *Considering Fraud in a Financial Statement Audit: Practical Guidance for Applying SAS No. 82*, walks auditors through issues likely to be encountered in applying the new SAS to audits, with valuable tools, such as sample documentation. It also provides specific guidance on applying the concepts of the SAS to various industries, including not-for-profit organizations. To obtain this publication (No. 008883) auditors should contact the AICPA Order Department at (800) 862-4272 or fax a request to (800) 362-5066.
- A self-study continuing professional education (CPE) course (No. 732045) entitled, *Consideration of Fraud in a Financial Statement Audit: The Auditor's Responsibilities Under SAS No. 82*, offers intermediate level information in test format and eight hours of recommended CPE. To obtain the CPE course auditors should contact the AICPA Order Department.
- Helpful guidance about the new SAS, including a press release, speech outline, and a comparison of SAS No. 82 with SAS No. 53, are available on the AICPA's home page.

Financial Statements on the Internet

It has become more common for not-for-profit organizations to make information available on the Internet or electronic bulletin boards

(electronic sites). Information in electronic sites may include financial statements and other financial information, press releases, and other promotional material. Auditors should be aware that an Interpretation of SAS No. 8, *Other Information in Documents Containing Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec. 550) entitled *Other Information in Certain Electronic Sites Containing Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec. 9550) has been issued to address an auditor's responsibility with respect to other information included in an electronic site if the audited financial statements and the independent auditor's report thereon are also included. The interpretation appeared in the March 1997 *Journal of Accountancy* and was effective upon publication.

The Interpretation concludes that electronic sites are a means of distributing information and are not documents in the sense that the term *documents* is used in SAS No. 8. Therefore, auditors are not required by SAS No. 8 to consider the consistency of information in electronic sites with the original documents or to read other information contained in electronic sites. The Interpretation also addresses the situation in which auditors are asked by their clients to consider information in electronic sites. It advises auditors that such consideration, which might take different forms, is not a service contemplated by SAS No. 8. However, other auditing or attestation standards may apply, for example, agreed-upon procedures.

Auditors should also note that the AICPA issued a nonauthoritative Practice Alert entitled, *Financial Statements on the Internet*, which describes distribution of audited financial statements and the related auditor's report on the Internet and speaks to several concerns for the auditor community. The Practice Alert is available on the AICPA's Fax Hotline at (201) 938-3787, document number 1566, and the AICPA's home page at <http://www.aicpa.org/pubs/cpaltr/jan97/suppl/prac.htm>.

Modifying Computer Systems for the Year 2000

Many computer systems process transactions based on storing two digits for the year of a transaction (for example 97 for the year 1997), rather than a full four digits. A significant number of computer systems based on two-digit years are not programmed to consider the start of a new century, unless they have been recently modified. Systems that process year 2000 transactions with the year 00 may encounter significant processing inaccuracies and even inoperability. The potential impact of the year 2000 problem on not-for-profit organizations is that date sensitive calculations would be based on erroneous data or could cause a system failure. All forms of financial accounting, including interest computations, due dates, pensions, personnel bene-

fits, investments, and legal commitments will be affected. It can also affect record keeping, such as inventory, maintenance, and file retention.

Fixing this problem will likely be a very long, involved, and expensive process for many organizations, requiring computer coding changes that will affect millions of lines of program code. Auditors should consider the consensus reached by the Emerging Issues Task Force (EITF) of the FASB in its discussion of Issue No. 96-14, *The Accounting for Costs Associated with Modifying Computer Software for the Year 2000*, which provides that costs specifically associated with modifying software for the year 2000 should be expensed as incurred. It may be advisable for auditors to consider discussing this matter with their clients to determine whether it is an issue and to determine whether the costs incurred to date have been accounted for properly.

Lawyers' Letters

An interpretation of SAS No. 12, *Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments* (AICPA, *Professional Standards*, vol. 1, AU sec. 337), was issued in January 1997. The Interpretation, entitled *Use of Explanatory Language Concerning Unasserted Possible Claims or Assessments in Lawyers' Responses to Audit Inquiry Letters* (AICPA, *Professional Standards*, vol. 1, AU sec. 9337) addresses a concern that the inclusion of certain explanatory comments in responses by lawyers to audit inquiry letters may result in a limitation on the scope of the audit. The interpretation appeared in the January 1997 issue of the *Journal of Accountancy* and was effective upon publication.

A number of lawyers include explanatory comments in their responses to audit inquiry letters that are intended to emphasize the preservation of the attorney-client privilege with respect to unasserted possible claims or assessments. These comments might include the following: "It would be inappropriate for this firm to respond to a general inquiry relating to the existence of unasserted possible claims or assessments involving the organization." The Interpretation states that the inclusion of this or similar wording in a lawyer's response does not result in a limitation on the scope of the audit. The Interpretation also reminds auditors of the requirement pursuant to SAS No. 12 to obtain the lawyer's acknowledgment of his or her responsibility to advise and consult with the client concerning financial statement disclosure obligations with respect to unasserted possible claims or assessments.

Pre-Award Surveys

As part of the process of applying for a government grant or contract, not-for-profit organizations may be required to submit a written

pre-award assertion (survey) by management about the effectiveness of the design of an entity's internal control or a portion thereof, together with an auditor's report thereon. An Interpretation of "Reporting on an Entity's Internal Control Over Financial Reporting" entitled *Pre-Award Surveys* (AICPA, *Professional Standards*, vol. 1, AT sec. 9400), was issued in February 1997. The Interpretation appeared in the February 1997 *Journal of Accountancy* and was effective upon publication. The Interpretation was issued to clarify that there are certain things that an auditor should not do in conjunction with a client's pre-award survey. The Interpretation states that the consideration of internal control in a financial statement audit does not provide a sufficient basis for auditors to issue a report expressing any assurance about the effectiveness of the design of internal control or any portion thereof. Other questions that are answered in the Interpretation include how auditors can report on the design effectiveness of an entity's internal control or a portion thereof, what auditors' responsibilities are if they are requested to sign a form prescribed by a government agency in connection with a pre-award survey, and whether auditors can issue reports on an entity's ability to establish suitably designed internal control.

Accounting Issues and Developments

Joint Costs

In 1987, the AICPA issued SOP 87-2, *Joint Costs of Informational Materials and Activities of Not-for-Profit Organizations That Include a Fund-Raising Appeal*. SOP 87-2 provides guidance on reporting the costs of informational materials that include solicitations for financial support, and requires such costs to be reported as fund-raising expenses if it cannot be demonstrated that a bona fide program or a management and general function has been conducted in conjunction with the appeal for funds. If such bona-fide program or management and general activities can be demonstrated, such costs should be allocated between fund-raising and the related program or management and general function. Certain financial statement disclosures concerning such allocations are also required.

Because of pressure to portray fund-raising expenses within certain percentages of revenue and expenses, there continues to be an increased risk that the cost of mailing materials or conducting other communications with the public may not be properly allocated between program expenses and fund-raising or management and general expenses in conformity with SOP 87-2.

Some state attorneys general continue to criticize the manner in which some organizations allocate joint costs. They believe that some

organizations have been too liberal in their allocation of costs to program expenses, especially those costs incurred to educate the public.

Not-for-profit organizations and auditors should carefully review the requirements of the SOP and consider the sufficiency of evidence that exists to support any allocations of such joint costs. An AICPA proposed SOP on this subject is discussed in the *Accounting for the Costs of Joint Activities* section of this Audit Risk Alert.

Religious Organizations

Some religious organizations are structured and operate under principles and practices based on their beliefs, including doctrines concerning control and authority, rather than corporate law or other structures. Accordingly, the relationships between and among such organizations, as well as the appropriate reporting for transactions they enter into, may be unclear. That lack of clarity may result in the following reporting issues:

- In some circumstances, control or authority is vested in another body or entity, either voluntarily or in accordance with principles followed by the organizations. In those circumstances, it may be unclear whether certain entities should be included in the consolidated financial statements of the reporting entity in conformity with the guidance in SOP 94-3, *Reporting of Related Entities by Not-for-Profit Organizations*.
- Assets may be owned by the reporting entity but held or perhaps even titled to another entity. (This circumstance is more likely to occur in situations in which one of the entities operates outside of the United States.) It may be unclear whether those assets should be reported as assets in the reporting entity's financial statements.
- In some circumstances, pension benefits and other employee benefits, including post-employment benefits, such as food, housing, life insurance, and medical benefits, may be administered by the either (1) a religious entity, (2) a separate corporate entity that is not in trust form, or (3) a separate corporate entity that is in trust form. It may be unclear which entity(ies) should report liabilities for unfunded obligations under either FASB Statement No. 87, *Employers' Accounting for Pensions*, or FASB Statement No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*.

Auditors should consider whether the financial statements represent the entity that they purport to represent and whether the accounting for benefit plans and related liabilities, if any, is appropriate and consistently applied.

As part of that consideration, auditors may wish to request the organization to obtain a specific opinion from legal counsel concerning the interpretation of principles, practices, canon laws, or other arrangements and related legal implications. SAS No. 73, *Using the Work of a Specialist* (AICPA, *Professional Standards*, vol. 1, AU sec. 336) provides guidance concerning circumstances in which auditors rely on the representations or work of an attorney for other than litigation, claims, and assessments as addressed in SAS No. 12, *Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments*.

Restructuring and Reengineering

Like many organizations, some not-for-profit organizations are restructuring and reengineering their operations to become more effective and efficient. Some organizations are recording restructuring and reengineering charges in the face of workforce reductions, facility closings, and the discontinuance of certain operations and programs. Auditors should consider the consensus reached by the EITF of the FASB in its discussion of EITF Issue No. 94-3, *Liability Recognition for Costs to Exit an Activity (Including Certain Costs Incurred in a Restructuring)*, which provides guidance on whether certain costs (such as employee severance and termination costs) should be accrued and classified as part of restructuring charges, or whether such costs would be more appropriately considered a recurring operational cost of the organization. EITF Issue No. 94-3 provides guidance concerning the appropriate timing of recognition of restructuring charges and prescribes disclosures that should be included in the financial statements. Also, auditors should consider the effects of such restructuring and reengineering, including the outsourcing of significant functions, on the organization's internal controls, and on the auditor's audit planning and testing.

Accounting Pronouncements and Projects

Recent key FASB pronouncements affecting not-for-profit organizations, which are discussed below, and their effective dates are summarized in exhibit 3.

Exhibit 3

| <i>Pronouncement</i> | <i>Effective Date</i> |
|---|---|
| FASB Statement No. 116, <i>Accounting for Contributions Received and Contributions Made</i> | Annual financial statements issued for fiscal years beginning after December 15, 1994, except |

(continued)

| <i>Pronouncement</i> | <i>Effective Date</i> |
|---|---|
| | for organizations with less than \$5 million in total assets and less than \$1 million in annual expenses (For those organizations, the Statement is effective for fiscal years beginning after December 15, 1995. Earlier application is encouraged.) |
| FASB Statement No. 117, <i>Financial Statements of Not-for-Profit Organizations</i> | Same as FASB Statement No. 116 |
| FASB Statement No. 119, <i>Disclosure about Derivative Financial Instruments and Fair Value of Financial Instruments</i> | Financial statements issued for fiscal years ending after December 15, 1994, except for organizations with less than \$150 million in total assets (For those organizations, the Statement is effective for financial statements issued for fiscal years ending after December 15, 1995.) |
| FASB Statement No. 121, <i>Accounting for Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of</i> | Financial statements issued for fiscal years beginning after December 15, 1995 |
| FASB Statement No. 124, <i>Accounting for Certain Investments Held by Not-for-Profit Organizations</i> | Financial statements issued for fiscal years beginning after December 15, 1995 |
| FASB Statement No. 125, <i>Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities</i> | Transfers and servicing of financial assets and extinguishment of liabilities occurring after December 31, 1996 |
| FASB Statement No. 126, <i>Exemption from Certain Required Disclosures about Financial Instruments for Certain Non-public Entities</i> | Financial Statements issued for fiscal years ending after December 15, 1996 |
| FASB Interpretation No. 42, <i>Accounting for Transfers of Assets in Which a Not-for-Profit Organization Is Granted Variance Power, (An Interpretation of FASB Statement No. 116)</i> | Financial statement issued for years ending after September 15, 1996 |

FASB Not-for-Profit Organizations Project. The FASB is continuing its consideration of the specialized accounting principles and practices pertinent to not-for-profit organizations. The FASB added this project to its agenda in March 1986, initially to address accounting for contributions and the recognition of depreciation by not-for-profit organizations. The portion of the project addressing depreciation was completed in September 1988 and resulted in FASB Statement No. 93, *Recognition of Depreciation by Not-for-Profit Organizations* (FASB, *Current Text*, vol. 1, sec. D40). The portion of the project addressing contributions was completed in June 1993 and resulted in FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made* (FASB, *Current Text*, vol. 1, sec. C67). The portion of the project addressing financial statement display was completed in June 1993 and resulted in FASB Statement No. 117, *Financial Statements of Not-for-Profit Organizations* (FASB, *Current Text*, vol. 1, sec. C25). The portion of the project addressing investments was completed in November 1995 and resulted in FASB Statement No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*. (FASB, *Current Text*, vol. 2, sec. No5)

Agency Transactions. In December 1995, the FASB released an exposure draft of a proposed Interpretation, *Transfers of Assets in Which a Not-for-Profit Organization Acts as an Agent, Trustee, or Intermediary* (An Interpretation of FASB Statement No. 116). After considering the comments received on the exposure draft, the FASB has decided to split this project into two separate pieces. One part of the project addresses situations in which the recipient organization has the unilateral power to redirect the use of the assets away from the specified beneficiary. FASB Interpretation No. 42, *Accounting for Transfers of Assets in Which a Not-for-Profit Organization Is Granted Variance Power* (An Interpretation of FASB Statement No. 116), issued in September 1996, addresses this. The other part of the project addresses other situations in which a donor specifies a third-party beneficiary, including accounting by that beneficiary for the contribution received. FASB Interpretation No. 42 provides that an organization that receives assets acts as a donee and a donor, rather than an agent, trustee, or intermediary, if a resource provider specifies a third-party beneficiary or beneficiaries and explicitly grants the recipient organization the unilateral power to redirect the use of the assets away from the specified beneficiary or beneficiaries (variance power).

Auditors should consider the wording used in the solicitations or gift agreements to determine whether resources received by not-for-profit organizations are received in agency transactions. This issue is

particularly pertinent for audits of community foundations, federated fund-raisers, and fund-raising foundations. Auditors should consider discussing these matters with clients as soon as possible, to avoid misunderstandings between clients and auditors concerning accounting for such transactions.

The balance of the issues covered in the exposure draft will be addressed in the second piece of the project. The period for commenting on the proposal has expired.

Extinguishment of Liabilities. In June 1996, the FASB issued FASB Statement No. 125, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities*. Among other things, the Statement requires that a liability be derecognized if and only if either (1) the debtor pays the creditor and is relieved of its obligation for the liability or (2) the debtor is legally released from being the primary obligator under the liability either judicially or by the creditor. Therefore, a liability is not considered extinguished by an in-substance defeasance. (The Statement supersedes FASB Statement No. 76, *Extinguishment of Debt*.)

Disclosures About Fair Value of Financial Instruments. In December 1996, the FASB issued Statement No. 126, *Exemption from Certain Required Disclosures about Financial Instruments for Certain Nonpublic Entities*. The Statement amends FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*, to make the disclosures about fair value of financial instruments prescribed in FASB Statement No. 107 optional for entities that meet all of the following criteria:

1. The entity is a nonpublic entity.
2. The entity's total assets are less than \$100 million on the date of the financial statements.
3. The entity has not held or issued any derivative financial instruments, as defined in FASB Statement No. 119, *Disclosure about Derivative Financial Instruments and Fair Value of Financial Instruments*, other than loan commitments, during the reporting period.

The Statement is effective for fiscal years ending on or after December 15, 1996. Earlier application is permitted in financial statements that have not been issued previously.

Consolidations. In October 1995, the FASB released an exposure draft of a proposed Statement, *Consolidated Financial Statements: Policy and Procedures*. The exposure draft would apply to not-for-profit organizations and would require a controlling organization to consolidate all

entities that it controls unless control is temporary at the time the entity becomes a subsidiary. For purposes of this requirement, control of an entity is the power to use or direct the use of the individual assets of another entity in essentially the same ways as the controlling entity can use its own assets. The exposure draft includes presumptions of effective control and indicators of effective control.

Not-for-profit organizations are currently required to follow SOP 94-3, *Reporting of Related Entities by Not-for-Profit Organizations*. If, however, the FASB Statement resulting from the exposure draft were issued and required to be applied by not-for-profit organizations, it would supersede SOP 94-3 to the extent that it is inconsistent with the FASB Statement resulting from the exposure draft.

The exposure draft would require the consolidation in all circumstances in which SOP 94-3 requires consolidation. Also, the exposure draft requires consolidation in circumstances in which SOP 94-3 permits but does not require consolidation. (SOP 94-3 does not include the presumptions of effective control. However, paragraph 12 of the SOP permits consolidation with certain kinds of control if coupled with an economic interest. Therefore, the circumstances in the exposure draft that result in effective control, and therefore consolidation, could result in consolidation being permitted but not required, under SOP 94-3.)

The period for commenting on the proposal has expired, and the FASB expects to conduct a sunset review of the project in June 1997.

AICPA Guide Project. In August 1996, the AICPA Not-for-Profit Organizations Committee issued the Audit and Accounting Guide *Not-for-Profit Organizations* (the Guide). The Guide incorporates certain provisions of FASB Statement Nos. 116 and 117 and is directed at not-for-profit organizations in general, and not at specific kinds of organizations, such as voluntary health and welfare organizations or private colleges and universities.

The Guide supersedes the following AICPA Audit and Accounting Guides:

- Industry Audit Guide *Audits of Voluntary Health and Welfare Organizations*
- Industry Audit Guide *Audits of Colleges and Universities*
- Audit and Accounting Guide *Audits of Certain Nonprofit Organizations*

It also supersedes the following AICPA SOPs:

- SOP 74-8, *Financial Accounting and Reporting by Colleges and Universities*
- SOP 78-10, *Accounting Principles and Reporting Practices for Certain Nonprofit Organizations*

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- SOP 87-2, *Accounting for Joint Costs of Informational Materials and Activities of Not-for-Profit Organizations That Include a Fund-Raising Appeal*
 - SOP 94-2, *The Application of the Requirements of Accounting Research Bulletins, Opinions of the Accounting Principles Board, and Statements and Interpretations of the Financial Accounting Standards Board to Not-for-Profit Organizations*

Some of the Guide's provisions are as follows:

The term *not-for-profit organizations* encompasses all entities defined as not-for-profit organizations by FASB Statement No. 116, including the kinds of organizations that were covered by the pronouncements that were superseded by the Guide.

If the financial statements include prior-year financial information that does not include sufficient detail to constitute a presentation in conformity with GAAP because it does not include the minimum information required by FASB Statement No. 117 and the Guide (for example, if the statement of activities does not present revenues, expenses, gains, and losses by net asset class), the nature of the prior-year information should be described by the use of appropriate titles on the face of the financial statements and in a note to the financial statements. The use of appropriate titles includes a phrase such as "with summarized financial information for the year ended 19PY," following the title of the statement or column headings that indicate the summarized nature of the information. Labeling the prior-year summarized financial information "for comparative purposes only" without further disclosure in the notes to the financial statements would not constitute the use of an appropriate title.

If such summarized comparative information that does not include the minimum information required by GAAP is presented, certain disclosures about the nature of the information presented are required. If the required disclosures about the nature of that information are omitted or are incomplete, the auditor ordinarily should add a paragraph to his or her report calling the omitted or incomplete disclosure to the readers' attention. To reduce the likelihood that a reader might misinterpret such a paragraph to be a qualified opinion on the current-period financial statements, the paragraph should follow the opinion paragraph and should not be referred to in either the scope or opinion paragraphs of the auditor's report.

Solicitations for donations that (1) clearly include wording such as "information to be used for budget purposes only" or that (2) clearly and explicitly allow resource providers the ability to rescind their indications that they will give are intentions to give rather than promises to give and should not be reported as contributions.

Not-for-profit organizations may receive contributions of the use of electric, telephone, and other utilities and of facilities (such as a building or office space) in which the donor retains legal title to the facilities. Organizations receiving such contributions should recognize contribution revenue in the period in which the promise is received and expenses in the period the utilities, facilities, or long-lived assets are used. (Whether such contributions should be reported is unaffected by whether the not-for-profit organization could afford to purchase the utilities or facilities at their fair value.) If the transaction is an unconditional promise to give for a specified number of periods, the promise should be reported as contributions receivable and as restricted support that increases temporarily restricted net assets.

If a contribution is transferred to the ultimate recipient through an agent acting as an intermediary, the ultimate recipient should report the contribution when sufficient verifiable evidence that the agent has received the promise to give or contribution becomes available.

Unconditional promises to give cash should be measured at fair value, based on the present value of their estimated future cash flows.

Contributions receivable are not accounts receivable that are required to be confirmed in accordance with SAS No. 67, *The Confirmation Process* (AICPA, *Professional Standards*, vol. 1, AU sec. 330). Although contributions receivable are not required to be confirmed, auditors may nevertheless decide to request confirmation of contributions receivable. If auditors confirm promises to give, they should follow the guidance in SAS No. 67 concerning the confirmation process.

For split-interest agreements, if the not-for-profit organization is the trustee, it should recognize the assets held under the trust at fair value and a liability for the present value of the expected future cash payments to be made to other beneficiaries. Contribution revenue should be reported for the present value of the cash flows expected to be received by the organization. If the not-for-profit organization is not the trustee, it should recognize contribution revenue and an asset representing its right to receive future cash flows. In all cases, all changes in the value of assets held under split-interest agreements are recognized in the financial statements.

Contributions of an irrevocable right to receive income from a perpetual trust held by third parties should be reported as permanently restricted support, with distributions reported as unrestricted or temporarily restricted investment income.

Contributions of inventory should be reported in the period received and should be measured at fair value. Estimates of fair value may be obtained from published catalogs, vendors, independent appraisals, estimated selling prices, and other sources. If methods such as estimates, averages, or computational approximations, such as average

value per pound or subsequent sales, can reduce the cost of measuring the fair value of inventory, use of those methods is appropriate, provided the methods are applied consistently, and the results of applying those methods are reasonably expected not to be materially different from the results of a detailed measurement of the fair value of contributed inventory. If the gifts have no value, as might be the case for certain clothing and furniture that cannot be sold or used either internally or for program purposes by the not-for-profit organization, the items received should not be recognized.

If collection items are not capitalized, auditors should perform procedures to understand the organization's controls over recording accessions (including contributions) and deaccessions of collection items, controlling the collections, and periodically physically inspecting them. Those auditing procedures are performed, in part, to provide evidence supporting the disclosures required by paragraph 27 of FASB Statement No. 116. They are also part of auditors' work in obtaining an understanding of the organization's controls over collection items and contributions of such items. The objective of performing those procedures when the collection is not recognized is not to obtain evidence to corroborate a recorded amount, since no amount has been recorded. Instead, the objective is to help auditors understand the organization's control environment, which is a component of its internal control.

FASB Statement No. 124 does not address measurement issues concerning investments other than investments in equity securities with readily determinable fair value and all investments in debt securities. Investments not covered by FASB Statement No. 124 are referred to in the Guide as *other investments*. Other investments include, among others, investments in real estate, mortgage notes, venture capital funds, partnership interests, oil and gas interests, and equity securities that do not have a readily determinable fair value. The Guide retains the measurement guidance for accounting for other investments included in the AICPA publications that will be superseded by the Guide, until such time as the FASB or AcSEC issues more definitive guidance, except as stated in the next sentence. To the extent that the guidance in the AICPA publications that will be superseded by the Guide requires all investments to be measured using the same measurement attribute, only other investments, rather than all investments, will be required to be measured using the same measurement attribute. For example, if an AICPA publication that will be superseded by the Guide permits investments to be carried at either cost or fair value, provided that the same attribute is used for all investments, and if equity securities with a readily determinable fair value are carried at fair value in conformity with the guidance in FASB Statement No. 124, other investments are

permitted to be carried at either cost or fair value, provided that the same attribute is used for all other investments.

FASB Statement No. 124 provides that net appreciation on donor-restricted endowment funds should be reported as changes in unrestricted net assets unless the appreciation is temporarily or permanently restricted by explicit donor-imposed stipulations or by law. Laws concerning net appreciation of donor-restricted endowment funds may vary from jurisdiction to jurisdiction. For example, some jurisdictions follow trust law, some follow the Uniform Management of Institutional Funds Act (UMIFA), some follow modifications of UMIFA, and some follow interpretations of those laws issued by state attorneys general. Generally, in jurisdictions following trust law, net appreciation is not spendable and, therefore, should be added to permanently restricted net assets. Accordingly, unless the donor has explicitly restricted the net appreciation on an endowment fund, net appreciation subject to such limitations should be reported as a change in unrestricted net assets. Also, it has generally been interpreted that, absent donor restrictions, net appreciation is spendable under UMIFA and therefore should be added to unrestricted net assets. (Legal limitations that require the governing board to act to appropriate net appreciation under a statutorily prescribed standard of ordinary business care and prudence do not extend donor restrictions to the net appreciation.) Auditors should obtain an understanding about these issues and the laws concerning net appreciation on donor-restricted endowments applicable to the reporting organization. Also, auditors should obtain representations from management about any interpretations made by the organization's governing board concerning whether laws limit the amount of net appreciation of donor-restricted endowments that may be spent. However, for organizations operating in jurisdictions in which there may be questions concerning interpretations of the applicable laws or where there are conflicting interpretations by various legal counsel, auditors should request the organization to obtain a specific opinion from legal counsel concerning interpretation of the legal requirements. SAS No. 73 provides guidance concerning circumstances in which auditors rely on the representations or work of an attorney for other than litigation, claims, and assessments as addressed in SAS No. 12.

Property and equipment used in exchange transactions (other than lease transactions), such as federal contracts, in which the resource provider retains legal title during the term of the arrangement, should be capitalized by the not-for-profit organization only if it is probable that the organization will be permitted to keep the assets when the arrangement terminates. The terms of such arrangements should be disclosed in notes to the financial statements.

Revenues from exchange transactions should generally be reported gross of any related expenses, rather than net of related expenses. If the organization regularly provides discounts (such as financial aid for students that is not reported as an expense, reduced fees for services, or free services) to certain recipients of its goods or services, revenues should be reported net of those discounts. (Net revenue may be reported as a single line item in a statement of activities, or the gross revenue is permitted to be reported less the related discount, provided that the discount is displayed immediately beneath the revenue.)

Some not-for-profit organizations provide reductions in amounts charged for goods or services, such as financial aid provided by colleges and universities. Reductions in amounts charged for goods or services provided by a not-for-profit organization should be recognized as expenses if such reductions are given in exchange for goods or services provided to the organization, such as part of a compensation package. Amounts recognized as expenses for such reductions should be reported in the same functional classification in which the cost of the goods or services provided to the organization are reported. If reductions in amounts charged for goods or services provided by a not-for-profit organization are given other than in exchange for services provided to the organization, such amounts should be reported as—

- Expenses if the organization incurs incremental expense in providing such goods or services.
- Discounts if the organization incurs no incremental expense in providing such goods or services.

Fund-raising costs, including costs incurred in one period that may result in contributions that will be received in future periods, should be expensed as incurred.

The costs of soliciting contributed services, such as volunteers, regardless of whether those services are recognized as contributions in conformity with the provisions of paragraph 9 of FASB Statement No. 116, should be reported as fund-raising.

The financial statements should disclose the total fund-raising expenses.

The financial statements should provide information about program expenses. If the components of total program expenses are not evident from the details provided on the face of the statement of activities, for example, if cost of sales is not identified as either program or supporting services, the notes to the financial statements should disclose total program expenses and should provide information about why total program expense disclosed in the notes does not articulate with the statement of activities. The financial statements should also provide a description of the nature of the organization's activities, including a

description of each of its major classes of programs, either on the statement of activities (for example, using column headings) or in the notes to the financial statements.

Occupying and maintaining a building is not a separate supporting service. Interest costs, including interest on a building's mortgage, should be allocated to specific programs or supporting services to the extent possible; interest costs that cannot be allocated should be reported as part of the management and general function.

Auditors should not report separately on operations if the statement of activities includes an intermediate measure of operations.

In addition, the Guide includes the following:

- A definition of a governmental entity
 - Indicators to distinguish exchange transactions from contributions
 - Indicators to distinguish contribution and exchange portions of membership dues.

The provisions of the Guide are effective for financial statements for periods ending on or after December 31, 1996.

Accounting for the Costs of Joint Activities. In February 1997, a proposed SOP, *Accounting for Costs of Activities of Not-for-Profit Organizations and State and Local Governmental Entities That Include Fund Raising*, was cleared for final issuance by the FASB and GASB, subject to certain revisions. The proposed SOP would be applied by not-for-profit organizations and state and local governmental entities in determining fund-raising costs. It would require entities to report the costs of all materials and activities that include a fund-raising appeal as fund-raising costs, including costs that otherwise might be considered program or management and general costs if they had been incurred in a different activity, unless the criteria of purpose, audience, and content, as defined in the SOP, are met. If the criteria of purpose, audience, and content are met, the joint costs of those activities would be allocated and costs that are clearly identifiable with fund-raising, program, or management and general functions would be charged to that cost objective.

The proposed SOP would be effective for years beginning on or after December 15, 1997. The AICPA is in the process of drafting those revisions and expects to issue the final SOP in the summer of 1997.

GASB—Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities. Issued in April 1997, this exposure draft would make sweeping changes to the financial re-

porting standards for public colleges and universities. The GASB is expected to issue a final Statement by mid 1998.

GASB—The Financial Reporting Entity: Affiliated Organizations. Issued in December 1994, this exposure draft would establish standards to determine whether an organization should be classified as an affiliated organization and, if so, would establish criteria to determine whether that affiliated organization is a component unit of a primary government's financial reporting entity. The GASB is expected to issue a final Statement by late 1997.

Nonauthoritative AICPA Audit and Accounting Literature

Continuing Professional Education Courses

The AICPA offers group-study and self-study courses. Group-study courses include the following:

- Audits of HUD-Assisted Projects
- Advanced Auditing of HUD-Assisted Projects
- The AICPA Survival Guide for the Not-for-Profit Auditor
 - Compliance Auditing
 - Cost Principles for Nonprofit Organizations Under OMB Circular A-133
- Getting Started With Nonprofit Organization Tax Issues
 - Implementing SFAS Nos. 116 and 117 in Financial Statements of Nonprofit Organizations
 - Nonprofit Accounting and Auditing Update
- Single Audit Requirements for Nonprofit and Governmental Organizations
- Solving Complex Single Audit Issues for Government and Nonprofit Organizations
 - Tackling Tough Tax Topics in Nonprofit Organizations
- Using the AICPA Not-for-Profit Organizations Audit and Accounting Guide
- Workpaper Preparation Techniques for Government and Nonprofit Organizations
 - Yellow Book: Government Auditing Standards

Self-study courses include the following:

- Accounting for Nonprofits: Contributions and Financial Statements
- Audit Requirements of OMB Circular A-133
- Audits of Rural Development and Housing Programs
- Communicating Material Noncompliance and Internal Control Weaknesses
 - Compliance Auditing
 - HUD Audits: A Comprehensive Guide
- Nonprofit Accounting and Auditing Update
- Not-for-Profit Organizations: Using the New AICPA Audit and Accounting Guide
- Solving Complex Single Audit Issues for Government and Non-profit Organizations
 - Understanding Federal Audit and Administrative Requirements
 - Working with the Revised Yellow Book on Government Auditing Standards

Videocourses include the following:

- Effective Yellow Book Auditing Videocourse
- 1997 Nonprofit Auditing and Accounting Videocourse

For more information about AICPA CPE courses, call the AICPA information hotline at (800) 862-4272.

Not-for-Profit Organizations Checklists

The AICPA's Technical Publications staff has developed various publications that may be of interest to readers of this Audit Risk Alert. For example, an annual publication entitled *Checklists and Illustrative Financial Statements for Not-for-Profit Organizations*, product number 008681, is a nonauthoritative Practice Aid designed to help those preparing reports and financial statements of not-for-profit organizations.

Technical Practice Aids

Technical Practice Aids is an AICPA publication that includes questions received by the AICPA's Technical Information Service on various subjects and the service's response to those questions. Sections

6960 and 7300 of *Technical Practice Aids* include questions and answers specifically pertaining to not-for-profit organizations. *Technical Practice Aids* is available both as a subscription service and in hardback form.

Industry Conference

The AICPA will hold its Fifth Annual Not-for-Profit Organizations Industry Conference on June 12 to 13, 1997 in Washington DC. The conference is designed for both practitioners and financial executives, and to provide technical information for those decision makers. An additional four CPE credit optional session entitled "OMB A-133 In-Depth 97," will be offered on the evening of June 11, 1997. For further information, call the AICPA CPE Conference Hotline at (800) 862-4272.

References for Additional Guidance

Federal Agencies—Administrative Regulations

Most federal agencies issue general administrative regulations that apply to their programs. These regulations provide general rules on how to apply for grants and contracts, how grants are made, the general conditions that apply to and the administrative responsibilities of grantees and contractors, and the compliance procedures used by the various agencies. The regulations are included in the *Code of Federal Regulations*.

Auditors should also be aware that many agencies have program-specific and other audit requirements that are not covered by OMB Circular A-133. Such requirements may relate to certain programs (such as student financial assistance or HUD-insured mortgage programs), as well as to contract audit requirements. Auditors may want to refer to the PCIE's *Revised Program Audit Guide Listing* for a summary of federal programs that have separate audit guides.

General Accounting Office

General Accounting Office (GAO) publications include the following:

- *Government Auditing Standards, 1994 Revision*—These standards, also referred to as the Yellow Book, relate to audits of government organizations, programs, activities, and functions, and of government funds received by contractors, nonprofit organizations, and other nongovernment organizations. The standards incorporate the AICPA Statements on Auditing Standards for fieldwork and reporting, and prescribe the additional standards needed to meet

the more varied interests of users of reports on governmental audits. These standards are available from the Government Printing Office (GPO), Superintendent of Documents, Washington, DC 20401; telephone (202) 783-3238; telefax (202) 512-2250; Stock No. 020-000-00-265-4.

- *Interpretation of Continuing Education and Training Requirements*—This provides guidance to audit organizations and individual auditors on implementing the CPE requirements of Government Auditing Standards (April 1991, 020-000-00250-6). This Interpretation is available from the GPO, Superintendent of Documents, Washington, DC 20401.
- *Assessing the Reliability of Computer-Processed Data*—This guidebook is intended mainly for auditors and evaluators, not for experts in data processing. It provides some guidelines on what auditors must do to satisfy the requirements of *Government Auditing Standards* (September 1990, GAO/OP-8.1.3).
- *Guide to Federal Agencies' Procurement of Audit Services from Independent Public Accountants*—This booklet provides a basic understanding of how independent public accountant (IPA) contracts should be awarded to officials unfamiliar with federal procurement. It discusses the special requirements of the Chief Financial Officers (CFO) Act (April 1991, GAO/AFMD-12.19.3).
- *How to Get Action on Audit Recommendations*—This guide is intended to help auditors get more action and better results from their audit work on governmental programs and operations (July 1991, GAO/OP-9.2.1).

Unless otherwise noted above, requests for copies of these publications should be sent to the GAO, P.O. Box 6015, Gaithersburg, MD 20884-6015. The telephone number is (202) 512-6000. Orders may also be placed by using the fax number (301) 258-4066. For copies of GAO reports and testimony, the status of GAO's open recommendations, and GAO's audit policy, check the GAO home page at: <http://www.gao.gov>. The GAO home page also contains the electronic version of *Government Auditing Standards*. For information on how to access GAO reports or other documents on the Internet, send an e-mail message with "info" in the body to: info@www.gao.gov.

Office of Management and Budget

Circulars. OMB issues grant management circulars to establish uniform policies and rules to be observed by federal agencies for the administration of federal grants. Federal agencies then adopt these

circulars in their regulations. The process for issuing grants management circulars includes due process with a notice of any proposed changes in the *Federal Register*, a comment period, and careful consideration of all responses before issuance of final circulars. Circulars and other documents relevant to audits of not-for-profit organizations are listed below. For copies of circulars and bulletins, write or call the Office of Administration, Publications Office, Room 2200, New Executive Office Building, Washington, DC 20503; telephone (202) 395-7332 or check the OMB home page at: <http://www.whitehouse.gov/WH/EOP/OMB/html/ombhome.html>. An alternate address is <http://www.sbaonline.sba.gov/ignet>.

OMB Circulars Relevant to Audits of Not-for-Profit Organizations

| <i>Circular Number</i> | <i>Applicability</i> | <i>Issue Date</i> |
|------------------------|---|--|
| A-21 (Revised) | Cost principles for educational institutions | May 1996 |
| A-110 | Uniform Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations | November 1993 |
| A-122 (Revised) | Cost principles for non-profit organizations | October 1995 |
| A-133 (Revised) | Audits of states, local governments, and nonprofit organizations | Revision expected before June 30, 1997 |

OMB Circular A-133 Compliance Supplement. The OMB Compliance Supplement sets forth the major federal compliance requirements that should be considered in an audit of states, local governments, and non-profit organizations that receive federal assistance. It supplements OMB Circular A-133. A revision to the supplement is expected to be issued before June 30, 1997. For a separate discussion of the Compliance Supplement, see the section of this Audit Risk Alert entitled "Regulatory and Legislative Developments."

Other Guidance. The *Catalog of Federal Domestic Assistance* (CFDA) is a government-wide compendium of federal programs, projects, services, and activities that provide assistance or benefits to the American public. The General Services Administration (GSA) is responsible for the dissemination of federal domestic assistance information through the catalog and maintains the information database from

which program information is obtained. A searchable version of the CFDA is available on the GSA home page, which is currently located at <http://www.gsa.gov/fdac>.

Program information provided by the catalog includes authorizing legislation and audit requirements. The GSA makes copies available to certain specified national, state, and local government offices. Catalog staff may be contacted at (202) 708-5126. The catalog may be purchased from the GPO by calling (202) 783-3238.

Program information is also available on machine-readable magnetic tape. The tape may be purchased by writing the Federal Domestic Assistance Catalog Staff (WKU), General Services Administration, Ground Floor, Reporters Building, 300 Seventh Street, SW, Washington, DC 20407, or calling (202) 708-5126.

Information Sources

Further information on matters addressed in this Audit Risk Alert is available through various publications and services listed in the table at the end of this document. Many nongovernment and some government publications and services involve a charge or membership requirement.

Fax services allow users to follow voice cues and request that selected documents be sent by fax machine. Some fax services require the user to call from the handset of the fax machine, others allow users to call from any phone. Most fax services offer an index document, which lists titles and other information describing available documents.

Electronic bulletin board services allow users to read, copy, and exchange information electronically. Most are available using a modem and standard communications software. Some bulletin board services are also available using one or more Internet protocols.

Recorded announcements allow users to listen to announcements about a variety of recent or scheduled actions or meetings.

All phone numbers listed are voice lines, unless otherwise designated as fax (f) or data (d) lines. Required modem speeds, expressed in bands per second (bps), are listed data lines.

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This Audit Risk Alert supersedes *Not-for-Profit Organizations Industry Developments—1996*.

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Practitioners should also be aware of the economic, industry, regulatory, and professional developments described in *Audit Risk Alert—*

1996/97, which may be obtained by calling the AICPA Order Department at the number below and asking for publication number 022180 (audit) or 060669 (compilation and review).

Information Sources

| Organization | General Information | Fax Services | Electronic Bulletin Board Services |
|---|---|---|---|
| American Institute of Certified Public Accountants | <i>Order Department</i> Harborside Financial Center 201 Plaza Three Jersey City, NJ 07311-3881 (800) TO-AICPA or (800) 862-4272 Information about AICPA CPE programs is available through the AICPA by calling (800) 862-4272 | <i>24 Hour Fax Hotline</i> (201) 938-3787 | <i>AICPA Home Page</i> The AICPA has a home page on the World Wide Web. It can be accessed at http://www.aicpa.org . |
| Financial Accounting Standards Board | <i>Order Department</i> P.O. Box 5116 Norwalk, CT 06856-5116 (203) 847-0700, ext. 10 | | The FASB has a home page on the World Wide Web. It can be accessed at either http://www.fasb.org or http://www.rutgers.edu/accounting/raw/fasb |
| U.S. Department of Education | Office of Inspector General U.S. Department of Education, Switzer Building, Room 4200 Washington DC 20202 (202) 205-5497 | | The U.S. Department of Education, Non-Federal Audit Team home page is currently located at http://www.gvi.net/~edoig |
| U.S. Office of Management and Budget | Office of Administration Publications Office Room 2200 New Executive Office Building Washington DC 20503 (202) 395-7332 | <i>Twenty Four Hour Fax Hotline</i> (202) 395-9068 for certain Circulars and Standards (202) 395-9088 for speeches and press releases | OMB has a home page on the World Wide Web. The address is http://www.whitehouse.gov/WH/EOP/OMB/html/ombhome.html . For information concerning publications, standards, and exposure drafts released for comments by Inspectors General refer to IGnet at: http://www.sbaonline.sba.gov/ignet/ |

(continued)

Information Sources (cont'd)

| Organization | General Information | Fax Services | Electronic Bulletin Board Services |
|--|--|--------------|---|
| National Association of College and University Business Offices | One Dupont Circle Suite 500 Washington DC 20036 (202) 861-2500 (202) 861-2583 (f) | | <i>Electronic Bulletin Board Service.</i> Modem access: (202) 861-8400 Internet access: telnet to bbs.nacubo.nche.edu. IP address: 198.76.77.2 The service can also be accessed through the IGnet (see above). |
| National Health Council | 1730 M Street, NW Suite 500 Washington DC 20036 (202) 785-3910 (202) 785-5923 (f) | | The National Health Council has a home page on the World Wide Web. The address is http://www.healthanswer.com |
| Other | | | The <i>Rutgers Bulletin Board</i> on the World Wide Web includes various accounting related databases. The address for the home page is http://www.rutgers.edu/accounting/raw.html . |
| U.S. General Accounting Office | U.S. Government Printing Office <i>Superintendent of Documents</i> Washington, DC 20401 (202) 783-3238 (202) 512-2250 (f) or U.S. GAO P.O. Box 6015 Gaithersburg, MD 20884 (202) 512-6000 (202) 258-4066 (f) | | The GAO has a home page on the World Wide Web. The address is http://www.gao.gov . |

